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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940—NO. 62.

ELECTRO-CHEMICAL ENGRAVING CO. INC.,
Petitioner,

—against—

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

BRIEF FOR PETITIONER.

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BRIEF FOR PETITIONER.

Opinions Below.

The memorandum opinion of the Board of Tax Appeals is printed at pages 18-20 of the record and has not been officially reported. The opinion of the Circuit Court of Appeals is printed at pages 66-70 of the record, and is reported in 110 F. (2d) 614.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 3rd, 1940. Jurisdiction is conferred by Section 240(a) of the Judicial Code, as amended by the Act of February 13th, 1925.

This cause comes here by virtue of a writ of certiorari granted on June 3rd, 1940.

The Statutes Involved.

Revenue Act of 1934, c. 277, 48 Stat. 680:

"Sec. 23. Deductions from Gross Income.

"In computing net income there shall be allowed as deductions:

* * * * * * * * *

"(f). Losses by Corporations.—In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

* * * * * * * * *

"(j). Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117(d)."

* * * * * * * * *

"Sec. 117(d). Limitation on Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000. plus the gains from such sales or exchanges * * *."

Statement of Stipulated Facts (R., pp. 18-37).

On March 1st, 1927, the petitioner, a New York corporation, purchased a factory for its own business use in Flushing, New York, for $156,764.51 ($150,000 plus expenses of $6,764.51). It paid $50,000 in cash, assumed an existing first mortgage indebtedness of $20,000, and executed a bond in the sum of $80,000 which was secured by a purchase money mortgage on the property. On or about March 14th, 1930, the petitioner paid the first mortgage indebtedness of $20,000 and thereafter paid off $40,000 on the purchase money bond and mortgage, leaving a balance thereon of $40,000. On September 1st, 1932 the petitioner defaulted in the payment of the sum of $4,000 required to be paid in reduction of the principal of the purchase money mortgage and in the payment of

all subsequent semi-annual instalments of principal, and defaulted in the payment of the semi-annual instalment of interest required to be paid on September 1st, 1934 and all subsequent semi-annual instalments of interest, and defaulted further in the payment of real estate taxes for the second half of the year 1932 and in the payment of all subsequent real estate taxes.

In December 1934 Bernard Weinbaum, who, by assignment, had become the owner and holder of the purchase money mortgage, brought an action of foreclosure, because of the defaults mentioned, against the petitioner in the Supreme Court of the State of New York. On or about *February 6, 1935* a judgment of foreclosure was duly entered, forever barring the petitioner from its right, title and interest and equity of redemption in the premises, and awarding a judgment in favor of Bernard Weinbaum and against the petitioner in the sum of $50,594.72, consisting of the sum of $40,000 representing the unpaid principal of the mortgage debt, interest of $2,100, and unpaid real estate and water taxes and penalties thereon in the amount of $8,494.72. Pursuant to the aforesaid judgment of foreclosure, the referee appointed by the court, sold the mortgaged premises on *March 7th, 1935,* to Simon Bergman for the sum of $21,000 subject to all unpaid taxes, assessments and water charges then a lien on the premises, and on *March 22nd, 1935* the referee executed a deed conveying title to the premises to said Simon Bergman, a person unknown to the petitioner.

The cost of the property to the petitioner was $156,764.51. From this was deducted the mortgage payable of $40,000, the reserve for depreciation amounting to $15,993.13, and accrual of taxes and interest in the sum of $12,009.17—a total deduction of

$68,002.30. This left a net loss to the petitioner of $86,762.21.

The petitioner filed its income and excess profits tax return for the calendar year 1935 with the Collector of Internal Revenue for the Third District of New York, and therein deducted this last amount from its income as a loss sustained during the year. In his notice of deficiency to the taxpayer for the return for said year the Commissioner added to income the accrued taxes and interest in the amount of $12,009.17, and disallowed the amount of $86,762.21 of the claimed loss of $88,762.21.

The Board of Tax Appeals ruled that the Commissioner was correct in adding to income the amount of $12,009.17, and that such amount should not be offset against the cost of the property to the taxpayer, with the result that such loss was increased to $100,771.38. Such loss, it further held, was not the result of a "sale or exchange" within the meaning of the Revenue Act, and allowed it in full. The Circuit Court reversed the Board and held that the loss was limited to $2,000.

The Questions Presented.

1. Was the loss suffered by petitioner upon the foreclosure of its property a loss resulting from a "sale or exchange" of a capital asset, within the meaning of Section 117(d) of the Revenue Act of 1934?

2. Was the foreclosure sale the specific event establishing petitioner's loss?

Summary of Argument.

Petitioner neither sold nor exchanged its property. It lost its property through the operation of the law of foreclosure. Its interest was extinguished by an involuntary disposition thereof, without consideration. The referee's sale merely implemented the decreed forfeiture of petitioner's estate. This divestiture was not a "sale" within the meaning of the Act, which contemplated conventional, *voluntary,* dispositions of capital assets *by* the taxpayer.

Moreover, the referee's sale was not the identifiable event establishing petitioner's loss. The "sale" was an incidental and purely ministerial act in the process of the foreclosure of petitioner's property. The loss, referable to the foreclosure as an integrated whole, was not attributable to any specific step in the foreclosure. In any event the loss was not established, with precision and finality, until after the expiration of the period within which the statutory deficiency judgment procedure could be invoked.

POINT ONE.

The judicial divestiture of petitioner's property was not a "sale" thereof within the meaning of Section 117(d) of the Revenue Act of 1934.

I.

Section 117(d), by its terms, is applicable only where the loss results from a "sale or exchange".

The Board held that "a foreclosure sale is not a sale or exchange within the purview of Section 117(d) of the Revenue Act of 1934" (R., p. 11, fol. 18). In reversing the Board, the Circuit Court stated that

it could perceive no "reason for discriminating between the liquidation of a taxpayer's interest through sales made by himself and sales made by an officer of the court" (R., p. 41, fol. 69; 110 F. (2d) at p. 616). The ruling, we submit, ignores the fundamental distinction between a sale (connoting contractual and dispositive volition) and a judicial divestment of title, *i. e.*, forfeiture by decree.

Implicit in the conception of a "sale" is its *voluntary*[1] character, the contractual participation of the seller in the transaction, his formulation of terms, and assent to the bargain—in short, the free play of volition. In the language of the Sixth Circuit, in a case which is here on a companion writ:

> "'Sale' is a word of precise legal import. Its elements are (1) parties competent to contract, (2) mutual consent, (3) a thing the absolute or general property in which is transferred from the seller to the buyer, (4) a price in money paid or promised. (*Butler* v. *Thomson,* 92 U. S. 412 414; *Williamson* v. *Berry,* 49 U. S. 495, 544.) * * * If any one of the above elements be absent, it is not a sale as that word is understood in its ordinary signification." (*Commissioner* v. *Hammel,* 108 F. (2d) 753.)

On the other hand, implicit in the conception of a judicial sale is its *involuntary* character. It has been

[1] In the field of contract, generally, this view has prevailed. The ordinary power of sale has reference to a conventional, contractual, disposition, not to a judicial sale (*Guaranty Trust & Safe Deposit Co.* v. *Green Cove S & M R Co.,* 139 U. S. 137). And a covenant against sale or assignment is not broken either by a transfer by operation of law (*Gazlay* v. *Williams,* 210 U. S. 41), or by a judicial sale *in invitum* (*Riggs* v. *Pursell,* 66 N. Y. 193).

described as an "adverse", "involuntary", "hostile" proceeding (see, generally, 35 C. J. 7, Sec. 1, *et seq.*; *Mitchell* v. *Bartlett,* 51 N. Y. 447, 452), in which the owner is not an actor, but is acted against. On such a sale owner and plaintiff "do not bear the relation of vendor and vendee to each other" (*Mitchell* v. *Bartlett,* 51 N. Y. 447, 452). Indeed, the owner has "no right, power or authority to deal with the purchaser" (id.). He must stand aside while the decree is carried through by the enforced stripping of his title. Not even by equitable fiction is he regarded as a party to the contract—made over the auction block—with the successful bidder. "In effect the contract is made with the *court* * * *" (*Lane* v. *Chantilly Corp.,* 251 N. Y. 435, 437), And the referee or master, who conducts the sale does so as "a representative of the court" (*Pewabic Mining Co.* v. *Mason,* 145 U. S. 349, 361-2); he is not under the control of any party to the litigation, nor is he "the agent of either to make the sale" (id.; see also, *Mitchell* v. *Bartlett, supra*).

It is thus apparent that the process of wresting title from one party and investing it in another through the device of a referee's deed (which the owner has neither signed, authorized, approved, nor even been consulted upon), lacks every essential attribute of a "sale" in the ordinary legal significance of the word.[2] In the lay mind as well the word "sale"

---

[2] Of course, in a special, narrowly literal sense, the "highest bidder" at the referee's "auction" of the property becomes the "purchaser" under the foreclosure judgment. But, as we have seen, the mortgagor is not the *seller* (see cases, *supra*)—a conclusion which makes it impossible to reconcile the decision below with the (presumably) normal, conventional intendment of the term "sale" as used in the statute. In its application to a particular taxpayer, Section 117(d) governs *his* transactions, deals with *his* gains, *his* losses, *his* capital assets and therefore with *his* sales and *his* exchanges.

evokes no mental picture of a judicial officer, with a writ in one hand and an auctioneer's hammer in the other, selling under compulsory judicial decree the property of one who stands by, powerless to prevent the transaction or dictate the price or terms thereof. In short, "there is nothing * * * in the language of the Act indicating that the Congress used the word 'sale' in any sense other than its precise legal import or plain and obvious meaning" (*Commissioner* v. *Hammel, supra*).

II.

Respondent's conception of the term: "foreclosure sale", involves, in effect, the deletion of the qualifying word "foreclosure", and the placing of a blind emphasis upon the word "sale". It requires, as well, a disregard of the historic significance of the term. To view a decreed foreclosure sale in isolation, and to wrap it in the meaning of a sale by treaty, is to ignore its essential nature and adopt a "distorted rather than the common meaning of the word 'sale'" (*Burnet* v. *Harmel,* 287 U. S. 103, 108).

That a change of ownership is an incident of a foreclosure action is not at all conclusive; nor, in view of the setting in which the change takes place, is that circumstance even persuasive of the inquiry of whether a "sale" has occurred (cf. *Burnet* v. *Harmel, supra*).

In the *Burnet* case, this court sustained the contention that the consideration for the granting of an oil and gas lease was taxable as ordinary income rather than income from a "sale or exchange", even though under the applicable law the lease was regarded as a present sale of the oil and gas in place. The normal

meaning of the term "sale" was held to control, "notwithstanding this incidental transfer of ownership * * *"

The Court of Appeals for the District of Columbia in *Hale* v. *Helvering,* 85 F. (2d) 819, likewise refused to permit the element of an incidental transfer of ownership to dominate the analysis. There the mortgagee compromised the balance of the mortgage debt for a certain sum paid by the mortgagor, and, as part of the compromise, surrendered the notes which secured the debt. The court rejected the contention that the mortgagee's loss resulted from a "sale" of the notes, as capital assets. This ruling was followed by the Second Circuit in the *Bingham* v. *Commissioner,* 105 F. (2d) 971.

III.

Persuasive evidence of the sense in which Congress used the term "sale" is found in the reports of the Congressional committees which considered the legislation.[3] The first capital loss limitation appeared in the Revenue Act of 1924 as Section 208 (c). When the measure was under consideration by the House Ways and Means Committee, the Committee noted, among other things, that under the Revenue Act of 1918 "there was a serious loss of revenue, *in that the initiative, as is always the case, remained with the taxpayer, who refrained from taking a profit but who did not hesitate to take a loss which could be deducted in full from his taxable income".* (H. Rep. No. 1388

[3] The doubt engendered by the conflicting opinions of the Circuit Courts would seem to furnish ample basis for a resort to these reports, under the rule stated in *Wright* v. *Mountain Trust Bank,* 300 U. S. 440, 463.

of the House Ways and Means Comm. on H. R. 13770, 67th Cong. 4th Sess.)

The Revenue Act of 1934 introduced the new method of taxing gains from the sale or exchange of capital assets which is set forth in Section 117 of the act, and at the same time limited the deductions of losses from sales or exchanges of capital assets to $2,000 in excess of the gains from such transactions. The reason for this change appears from the following excerpts from the report upon the bill of the House Ways and Means Committee (House Report #704, 73rd Cong. 2nd Sess.):

> "Existing law provides in section 101 for a special treatment of the gains and losses resulting from the sale of capital assets held over 2 years * * *
>
> "Our present system has the following defects:
>
> "First. It produces an unstable revenue—large receipts in prosperous years, low receipts in depression years.
>
> * * * * * * * *
>
> "Third. *Taxpayers take their losses* within the 2 year period and get full benefit therefrom, and delay taking gains until the 2 year period has expired, thereby reducing their taxes."
>
> * * * * * * * *
>
> "Fifth. In some instances, normal business transactions are still prevented on account of the tax.
>
> "* * * Your committee recommends the following plan:
>
> "First. To measure the gain or loss *from the*

sale of property by an individual according to the length of time he has held the property, only the following percentages of the recognized gain or loss are taken into account for tax purposes:

"One hundred per cent if the capital asset has been held for not more than 1 year;

"Eighty per cent if the capital asset has been held for more than 1 year but not more than 2 years;

* * * * * * * *

"It is believed that the adoption of this plan (see Sec. 117 of the bill) will result in much greater stability in revenue, will give all taxpayers equal treatment, will encourage *normal business transactions,* and will yield substantially greater revenue. * * *"

Commenting on the above quoted language of the above mentioned report, the Third Circuit, in *Commissioner* v. *Freihofer,* 102 F. (2d) 787, said:

"These statements, which were quoted with approval by the Finance Committee of the Senate in its report upon the bill (Senate Report No. 558, 73rd Cong., 2d Sess.), show quite convincingly that *it was the intent of the Congress to deal in Section 117 with gains and losses resulting from the voluntary sale of capital assets.* The Committee said that the plan of taxation contained in the act was 'to measure the gain or loss from the sale of property by an individual according to the length of time he has held the property'. It would be difficult to find a clearer statement of the Congressional intent than this. We think it compels the conclusion that the sale

of capital assets referred to in Section 117 are those sales only which are *voluntarily* made by a taxpayer and that *judicial sales made by the sheriff in execution of a judgment in a proceeding for the foreclosure of a mortgage given by a prior owner are not included.*" (Italics ours.)

IV.

The ruling of the Board, in the instant case, is in harmony with a long line of identical rulings (see, among others, *Warfield* v. *Commissioner,* 38 B. T. A. 908; *Rust* v. *Commissioner,* 38 B. T. A. 910; *Jones* v. *Commissioner,* 39 B. T. A. 531; *Hill* v. *Commissioner,* 40 B. T. A. 376; *Fowler* v. *Commissioner,* 40 B. T. A. 1292; cf. *Nebraska Bridge Supply & Lumber Co.* v. *Commissioner,* 40 B. T. A. 40 [tax sale]; *Ganopuls* v. *Commissioner,* 39 B. T. A. 1120 [termination of estate by forfeiture. notice]), and is supported, moreover, by carefully considered decisions of the Third and Sixth Circuits (*Commissioner* v. *Freihofer,* 102 F. (2d) 787; *Commissioner* v. *Hammel,* 108 F. (2d) 753).

In the *Freihofer* case, the Third Circuit said:

> "Blackstone defined a sale as 'a transmutation of property from one man to another in consideration of some price or recompense in value' 2 Bl. 446. It is a contract for the transfer of property from one person to another for a valuable consideration. See 7 Words and Phrases, First series, Sale, page 6291. There must be parties standing to each other in the relation of buyer and seller, their minds must assent to the same proposition, and a consideration must pass.

Butler v. *Thomson*, 92 U. S. 412, 23 L. Ed. 684. Where the word is used, in the absence of anything to the contrary it will be assumed that the word is intended to have its usual signification. *De Ganay* v. *Lederer*, 250 U. S. 376, 39 S. Ct. 524, 63 L. Ed. 1042; *State* v. *Colonial Club*, 154 N. C. 177, 69 S. E. 771, 31 L. R. A. N. S. 387, Ann. Cas. 1912A, 1079. That signification includes voluntary action by the owner and a consideration. Here the taxpayer, the owners of the properties involved in the foreclosures, were not parties to the sheriff's sales, nor did they receive any part of the price obtained at those sales. These were, therefore, not sales in the ordinary sense. On the contrary they were adverse judicial proceedings whereby the titles of the taxpayers were extinguished, as we shall presently point out, without any recompense."

The *Freihofer* case was followed by the Sixth Circuit, in the *Hammel*[4] case. There the court, after adverting to the contractual connotation of the term "sale", said:

"The respondents in the case at bar were not

[4] The attempt of the court below to distinguish the *Hammel* case from the case at bar seems factually and legally untenable. A reading of the opinion in the *Hammel* case hardly justifies the assumption of Judge A. N. Hand that a "strict foreclosure" was there involved; nor, since a deficiency judgment was obtained against Mr. and Mrs. Hammel, and an appeal had been taken by them, is there basis for the apparent assumption that they were not parties to the foreclosure action. Be that as it may, the *Hammel* case was decided on no such narrow grounds; on the contrary the ruling was put forth on the broad ground that the Hammels "were deprived of their interest in the property not by sale but *by an adverse judicial proceeding which completely extinguished their title without consideration.*"

parties in the sheriff's sale and neither contracted for nor consented to it and received no part of the consideration. They were deprived of their interest in the property not by sale but by an adverse judicial proceeding which completely extinguished their title without consideration. The foreclosure was the identifiable event which established their loss. However, it was not established by a sale as that word is used in Section 117 of the Revenue Act of 1934. *Commissioner of Internal Revenue* v. *Freihofer,* 102 Fed. (2d) 787 (C. C. A. 3); *Burnet* v. *Harmel,* 287 U. S. 103, 107; *Hale* v. *Helvering,* 85 Fed. (2d) 819 (C. C. A. D. C.)."

In their essential features, both the *Freihofer* and the *Hammel* cases are indistinguishable from the instant case: in each case the taxpayer had been stripped of his title by foreclosure. The legal significance of such a result, in the light of federal taxation statutes, "is a federal question" (*Lyeth* v. *Hoey,* 305 U. S. 188, 193). "It is not determined by local characterization" (id.), nor by variations in the pattern of local foreclosure procedures. On the contrary, the will of Congress controls, and should be interpreted "so as to give a uniform application to a nationwide scheme of taxation" (*Burnet* v. *Harmel,* 287 U. S. 103, 110; *Lyeth* v. *Hoey, supra*).

Still other cases have been resolved by the same test, *i. e.,* whether the transfer was the result of a *voluntary* cession of title. Thus it has been held that a transfer in lieu of foreclosure (*Rogers* v. *Commissioner,* 103 F. (2d) 790, C. C. A. 9, cer. den. 308 U. S.

580; *Wieboldt* v. *Commissioner,* 113 F. (2d) 384,[5] C. C. A. 7), or even under threat of foreclosure (*Pender* v. *Commissioner,* 110 F. (2d) 477, C. C. A. 4; *Philips* v. *Commissioner,* 112 F. (2d) 721, C. C. A. 3), in consideration of a cancellation the indebtedness, constitutes a sale.

The sense of these rulings is indicated by the following excerpt from the opinion in the *Philips* case, *supra*:

> "We think that the Board of Tax Appeals properly held the transaction to be a sale or exchange. In *Commissioner* v. *Freihofer,* 3 Cir., 102 F. (2d) 787, 125 A. L. R. 761, this court held that the words 'sale' and 'exchange' as used in Section 117 connote voluntary action by the owner and a consideration. In the present case the petitioner's conveyance was voluntary. Even though it was made under threat of foreclosure, the petitioner had a choice and his exercise of this choice was his voluntary act. *Pender* v. *Commissioner,* 4 Cir., 110 F. (2d) 477. Likewise he received a valuable consideration, relief from his personal liability to pay three years taxes. The elements of a sale were thus present."

---

[5] In that case the court noted the conflict between the *Freihofer* and *Hammel* cases and the instant case, and, after observing that "the conflict between the three decisions will no doubt be resolved by the Supreme Court which has granted certiorari in the *Electro-Chemical* case * * *" said:

> "We consider it significant, however, that in two other cases involving the question presented by the case at bar, of the applicability of the section to *voluntary* transfers to avoid foreclosure proceedings, *Rogers* v. *Commissioner,* 9 Cir., 103 F. (2d) 790, and *Pender* v. *Commissioner,* 4 Cir., 110 F. (2) 477, the Supreme Court has denied certiorari (October 9, 1939, *Rogers* v. *Commissioner,* 308 U. S. 580, 60 S. Ct. 98, 84 L. Ed.—, and June 3, 1940, *Pender* v. *Commissioner,* 60 S. Ct. 1103, 84 L. Ed.—). It is fair to infer from this action that the Court found no conflict between these decisions and those involving involuntary sales."

In the case at bar the learned Circuit Court flatly rejected the test applied in the foregoing cases, saying: "Between a situation adjusted by cancellation of the mortgage notes in return for a 'voluntary' deed of the land, when the adjustment is made with knowledge of the possible resort to foreclosure, and a situation where foreclosure is actually resorted to, there would seem to be little difference" (110 F. (2d) at p. 616). Indeed, as the decision below attests, the opposing situations presented no point of difference whatever to the mind of the Court. The best answer to this sweeping assertion may be made in the language of respondent, in opposition to the application for *certiorari* in the *Rogers* case, *supra*:

> "Petitioners insist that the transfer was made in lieu of foreclosure and that the transaction must, therefore, be considered in the same light as foreclosure. *But this would have been a wholly different transaction,*[6] both involuntarily

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[6] This view, asserted for the purpose of defeating certiorari in the *Rogers* case, was abandoned by the Commissioner after the denial of certiorari. Compare the quoted statement with the following language of the Commissioner's brief (pp. 17-18) in the Circuit Court, in the instant case:

> "The only distinction between that (*Rogers*) case and this is that the sale here was not made by the taxpayer, *a distinction which we will show to be of no significance.*"

Shortly thereafter, however, the distinction was revived by the Commissioner, in opposing a review of the *Pender* case:

> "*The question in the Electro-Chemical, Hammel and Freihofer cases is plainly different from the question here. This was not an involuntary foreclosure sale of the mortgaged premises ordered by the court and involving the risk of a deficiency judgment;* it was rather a *voluntary* transfer made by the petitioners, not only of the mortgaged property but also of other unencumbered property owned by them. *The petitioners contracted for and consented to the transfer and they received the consideration for the transfer.* The transfer must, therefore, be regarded as a sale, irrespective of the conclusion which the Court may ultimately reach in the *Hammel* case" (Respondent's Brief, p. 8, in Opposition to Petition for Certiorari, in *Pender* v. *Commissioner*). (Italics ours.)

> on the part of petitioners and involving the risk of a deficiency judgment" (Commissioner's Brief, (p. 9), in opposition to petition for certiorari in *Rogers* v. *Commissioner;* cer. den. 308 U. S. 580).

It should be noted, moreover, that, at page 8 of the brief just referred to, the Commissioner—who now insists that the *Freihofer* case, *supra,* was wrong—did not even intimate a doubt as to the correctness of that decision, but, on the contrary, apparently accepted the test applied in the *Freihofer* case, by arguing that that case "obviously has no application to and is not in conflict with the present (*Rogers*) case, *since the transfer here resulted from the voluntary action of the decedent and his wife,* for which they received a valuable consideration". (Italics ours.)

V.

We have already noted that the court below rejected the notion that the question of the applicability of Sec. 117 (d) could turn upon the circumstance of the voluntary or involuntary character of a particular "sale". It sought to fortify its view by the following analogy:

> "We should be surprised if a taxpayer who had pledged securities with a broker and had them sold out on the Stock Exchange could obtain a deduction of more than $2000 for a capital loss incurred through such a liquidation. If the sale were made at the pledgor's request it could not be doubted that 117 (d) would apply and that no loss in excess of $2,000 could be deducted for

> income tax purposes. *Rogers* v. *Commissioner*, 103 F. (2d) 790 (C. C. A. 9). Likewise, if the customer realized a gain through such a liquidation he would be entitled to limit his taxable gain in computing net income to the percentages provided by Section 117 (a). It cannot be supposed that it would make any difference whether a pledgee ordered or merely suffered his securities to be sold by his broker, and we think that in either event he could limit his taxable gain by the percentages under Section 117 (a) and could take a deduction of only $2,000 for any loss that he might suffer. We see no valid distinction between a sale by a broker who holds his customer's securities and a sale of mortgaged real estate by means of a decree in foreclosure" (fol. 69).

This attempted analogy, we submit, proceeds upon an erroneous premise, *i. e.*, that the sale of securities pledged with a broker is an *involuntary* sale. Ordinarily, the exact contrary is the case. It is common knowledge that the conventional margin account is subject to a written margin agreement, which authorizes the broker to sell pledged securities *for the account of the customer*. A sale of securities so pledged is therefore a *voluntary* sale, made by a duly authorized agent, pursuant to a power expressly conferred.

A fundamentally different situation is presented by this record. There was no power of sale in the mortgage. There was no sale by the petitioner; there was none by the mortgagee, in petitioner's behalf. What occurred was a judicial sale, *in invitum*, to implement the decreed forfeiture of petitioner's estate.

Neither in fact, nor in theory, was the referee who conducted the sale the agent of petitioner (*Pewabic Mining Co.* v. *Mason,* 145 U. S. 349, 361-2; *Mitchell* v. *Bartlett,* 51 N. Y. 447, 452). He was the "representative of the court" (*Pewabic Mining Co.* v. *Mason, supra*), deriving his powers not from a contractual grant of authority, but from a judicial commission. To attribute to the execution of this commission the legal equivalence of a sale by private warrant is to ignore both legal principle and economic reality.

VI.

The court below perceived a threat to the national revenue in the acceptance of the proposition that the $2000 limitation was inapplicable to an involuntary disposition of a capital asset. It noted its concern in the following language:

> "If capital losses were limited to $2,000 only in case of voluntary sales a taxpayer could frequently secure the benefit of an ordinary loss deduction through liquidation of pledged or mortgaged property by a friendly broker or mortgagee. It seems to us quite unlikely that the national revenue can be affected by such distinctions or by the accident of who causes the sale to be made" (fol. 70).

The Commissioner has stipulated that in the instant case the foreclosure was a real one, the petitioner's loss an actual one, and its computation a correct one. To say to an honest taxpayer that he is denied the benefits of a plain provision of the Revenue Act because the Act is susceptible of fraudulent misuse by a dishonest taxpayer, is indeed a startling and

novel judicial utterance. There is ample provision in the federal criminal laws and, indeed, in the very Revenue Act of 1934 (secs. 145 and 293 (b)), to safeguard the public interest against fraudulent tax evasion. It is not the function of courts to plug assumed holes in the Revenue Act, by judicial legislation. "Laws enacted with good intention, when put to the test, frequently, and to the surprise of the lawmaker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law making authority, and not with the court" (*Crooks* v. *Harrelson,* 282 U. S. 55, 60). Certainly, if every tax statute were construed in the light of what a dishonest taxpayer might do through collusion, fraud or evasion, an honest taxpayer would never have his rights adjudicated on the *real* facts of his particular case. However, the concern of the Second Circuit is academic; the question can no longer arise, for, since the Revenue Act of 1938, property such as is here involved is no longer within the classification of a "capital asset".

POINT TWO.

The foreclosure sale was not the identifiable event establishing petitioner's loss.

Since the mortgage contained no power of sale (cf. Real Property Law (N. Y.) Art. 17, Sec. 540 *et seq.*) the instant foreclosure necessarily took the form of a judicial foreclosure (Civil Practice Act (N. Y.) Art. 65, Sec. 1077 *et seq.*). Generally speaking, foreclosure actions under the Civil Practice Act follow the traditional pattern of such suits, save, perhaps, for an enlightened and realistic deficiency judgment procedure. The judgment pronounces the foreclosure,

i. e., the forfeiture of estate.[7] In a very real sense the judgment, with its declared consequence of the extinguishment of title or equity of redemption, not only is the identifiable, but the precisely *identified*, event from which the loss naturally flows.

But the judgment is obviously not self-executing. To "enforce the judgment" (*Morris* v. *Morange*, 38 N. Y. 172, 174) a referee must sell the property, in obedience to the court's command. That, however, is not the identifiable event by which either the *factum* or the *quantum* of the loss is established. The sale is an incidental and "purely ministerial" act (*Morris* v. *Morange, supra*). It is but a link in the chain of the foreclosure proceedings, a step in the action itself. It is a part of the whole and has no independent status or significance.

"The *foreclosure* was the identifiable event which established (petitioner's) loss" (*Commissioner* v. *Hammel, supra*); but the foreclosure must be viewed as an integrated whole, as a judicial process, proceeding step by step, and achieving its ultimate legal effect from the sum of all its parts.

In this view there can be no rational selection of a particular part as the "specific" or "identifiable" event establishing the loss, without the distortion of essential values. But even were this not so, the foreclosure sale could still not be said to be the event establishing the loss. The judgment, respon-

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7. "ORDERED, ADJUDGED AND DECREED that both of said defendants in this action * * * be and they hereby are forever barred and foreclosed of all right, title and interest, claim, lien and equity of redemption in said mortgaged premises or any part thereof * * *" (R., pp. 33-34).

sively to the statute, contained the following provision:

> "ORDERED, ADJUDGED AND DECREED that the plaintiff may apply at the foot of this judgment *after* a sale thereunder, pursuant to Sec. 1083(a) of the Civil Practice Act for judgment herein against the defendant Electro-Chemical Engraving Company, Inc. for such deficiency, if any, as the court shall deem the plaintiff entitled to * * *" (R., pp. 32-33).

Until the expiration of "ninety days after the date of the consummation of the sale by the delivery of the proper deed of conveyance to the purchaser * * *" (C. P. A., Sec. 1083 (a)), petitioner did not and could not know whether a motion for a deficiency against it would be made and if made, granted; and if granted, to what extent. Until then petitioner could not know what the amount of the ultimate judgment against it would be; and, while no deficiency was in fact applied for, petitioner did not and could not know the exact amount of its loss until at least after the ninety days had elapsed.

The ultimate fixation and determination of petitioner's actual loss was contingent upon the final outcome of the foreclosure litigation. It was not and could not be determined by the judgment; it was not and could not be determined by the "sale" conducted by the Referee; and it was not and could not be determined by the Referee's deed of conveyance. It became fixed with precision and finality, only when the period within which the mortgagee could have invoked the deficiency judgment procedure, was at an end (cf. *Commissioner* v. *Hawkins,* 91 F. (2d) 354,

C. C. A., 5, where it was held that a loss due to a foreclosure occurred at the end of the period of redemption and not when the foreclosure sale took place).

CONCLUSION.

The judgment of the Circuit Court should be reversed.

Respectfully submitted,

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